

Ofgem  
9 Millbank  
London  
SW1P 3GE

24 June 2013

Dear Joanna,

Thank you for the opportunity to respond to your open letter consultation on the implementation of new funding, governance and ownership arrangements for Xoserve. Northern Gas Networks (NGN) has been actively engaged in the review and while we continue to seek assurance that the importance and priority of the gas transporter invoicing activity as carried out by Xoserve remains of the highest priority we can see benefits in a change in the overall direction as proposed.

NGN believes that in order to ensure an effective transfer of responsibilities it is critical that the invoicing arrangements between Xoserve and shippers are direct. This should be not only as a result of them being the main or sole recipient of particular services but also as a result of transfer of obligations to licensees other than transporters where appropriate. While it is the GT Licence Condition A15 which requires the transporters to have an Agency, it is the Uniform Network Code (UNC) where the details of that arrangement exist. A full review of responsibilities within the UNC and subsequent modifications will be the most effective manner in re-aligning responsibilities which can then be mirrored within the revised funding and governance arrangements.

While we note that the CEPA documents envisage an April 2014 completion of this work, we are concerned that the timescales suggested by them have already slipped and we believe that a firm commitment by all parties to complete the work required by April 2015 would be more achievable. As noted above, a significant UNC modification to realign responsibilities will in itself take a considerable time to complete and this must also be aligned to any legal arrangement in respect of shareholder agreements and company documents. We do continue to have some concerns that there is a large amount of industry change which is now seeking to complete at around the same time – e.g. smart metering mass roll-out, Project Nexus (UK Link replacement), EU driven changes. These will no doubt interact with each other both in terms of system requirements but also industry resources to provide the necessary expertise to ensure that these all meet various licence and code obligations.

I hope you find these comments useful and please contact me should you require any further information.

Yours sincerely,



Joanna Ferguson  
Network Code Manager

## **Questions for consultation**

### *Service delivery*

1. *Do you agree that there are benefits in retaining the central service provider as one delivery body for all systems and services, including Gemini systems? Do you consider there to be an alternative structure with greater benefits? Please provide evidence of these additional benefits.*

The central service provider arrangements ensure that all parties have consistent procedures. This arrangement was considered to be the most efficient way to facilitate the network sales in 2005 and remains a key feature of the current regime. By ensuring that shippers only need make one set of IS arrangements to manage supply point administration and billing for all large GTs it is simpler to maintain efficient systems and make necessary changes when changes are necessary. The inclusion of Gemini in the Xoserve management further ensures that trading, balancing and transportation activities are integrated into single future IT plan for the industry. NGN does not consider that this arrangement should be changed.

### *Budget setting, cost allocation and charging*

2. *Do you agree with our preliminary recommendation for how future budgeting, charge setting and invoicing arrangements should work? Do you consider there to be greater benefits in establishing other arrangements? Please state your reasons why.*

The recommendations for future budgeting, charge setting and invoicing are consistent with the principle of changing to co-operative management of the central service provider. Budgeting, while important for short term charge setting and performance management, also needs to maintain oversight of the longer term future with the industry being aware of the longer term plans that may have been approved by the Board. It is NGNs view that the existing long term planning cycle should remain in place with Board oversight. Annual budgets which drive the specific charges to customers can then be presented to the industry in the context of the longer term requirements which is likely to reduce queries and ensure that all parties understand the composition of their budgeted charges.

NGN considers that the requirement to change the existing charging methodology is highly likely to facilitate the new regime. This change will need to consider all aspects of the current cost base including future change. As this is likely to involve a significant change to the existing methodology it is important that the new cost targeting is agreed by industry parties in order to reduce the likelihood of future challenge to the structure of charges. A clear methodology statement will ensure that parties are able to forecast their own charges with some degree of certainty in order to allow those charges to then be appropriately targeted to their own customers.

Invoicing directly to shippers will ensure that full responsibility for those charges are efficiently transferred from the current transporter pays regime to a more targeted arrangement. Once the charging methodology is agreed and systems for managing this are set up it is likely that Xoserve will need to expand their existing finance function to manage the additional volumes of invoicing, credit management and cash collection. This cost would not be likely to be material as long as appropriate contractual arrangements are in place for the invoicing and credit terms.

Arrangements should also be made to ensure that in Xoserve is protected from the failure of an industry party in respect of the core services provided to them given that it is to be operated as a not-for-profit organisation. As it is in the interests of all

industry parties to ensure the ongoing efficient operating of Xoserve this aspect is not likely to be contentious.

3. *What are your views on the measures we have identified to ensure regulatory oversight is maintained?*

Obligations on all parties for the ongoing efficient operation of Xoserve through a Licence requirement should ensure that parties are suitably incentivised to consider the overall health of Xoserve and maintain efficient operation for the benefit of the whole industry.

A low level of regulatory oversight is welcomed although NGN does not believe it likely that there would be need for intervention. A clear budget setting process combined with a transparent charging methodology should ensure that parties have suitable visibility of future costs and unforeseen material changes that put at risk the ability of Xoserve to deliver customers obligations should be notified to both the regulator and the wider industry at the earliest opportunity.

4. *Do you consider there to be further barriers to adopting a new cost reflective charging methodology which we have not considered? What would be the cost of you to establish a new cost reflective charging methodology?*

Development of a new charging methodology will undoubtedly require resource being made available by all industry participants to carry out suitable analysis of available data and make recommendations on any new proposed arrangements. Provision of data by Xoserve for this purpose may take time to compile and it is essential that sufficient notice of these requirements is made. NGN believes that there is likely to be a requirement for additional resource within Xoserve during the development of the new methodology in order to support industry discussions. It is important that industry resource for developing an appropriate methodology is suitably qualified to consider the impacts of both the financial and organisational structure changes that this may drive.

5. *Do you consider there to be further barriers of the central service provider directly invoicing users? What would be the cost to you of the central service provider directly invoicing users?*

Direct invoicing of shippers by Xoserve will increase the existing accounts receivable function within Xoserve. The calculation of the charges once the new methodology is set and the budget agreed is likely to be more complex than existing split of overall costs between the Gas Transporters. This element will need new systems to ensure that invoices are generated accurately and on time. Xoserve already carries out a small level of accounts receivable for the non-code User Pays service and bi-lateral contracts but the proposed level of change may need to be more than merely increasing the size of the existing facility.

Most shippers already procure some non-code User Pays or bi-lateral services from Xoserve, so it is likely that they already have Xoserve within their finance systems as an approved vendor. The proposed change may require new processes for approval of invoices, but otherwise NGN does not believe that this will have significant impact on organisations. This key aspect of the proposed arrangements will ensure that

users of Xoserve services have full visibility of those services and the costs of incurring them.

NGN does not anticipate any costs or changes to be required within our own internal financial systems to facilitate this change.

#### *Corporate governance*

6. *Do you agree with our preliminary recommendation to apply the full co-operative model with retained GT ownership? Do you consider there to be greater benefits in establishing alternative arrangements? Please state your reasons why.*

Throughout the CEPA workshops the issue of ownership received little consideration by industry parties. It is essential that control and risk are aligned appropriately but this does not necessitate a particular ownership model. Keeping the status-quo on ownership reduces the legal and administrative requirements for Xoserve Limited.

Reduction in levels of both control and risk for Gas Transporters will necessitate changes in the existing shareholder agreement, articles of association and memorandum of association to reflect new responsibilities and ensure that Gas Transporters are appropriately protected from the change of Xoserve becoming an uncontrolled shareholding. Provided this is done in an appropriate manner the proposed structure should be achievable.

7. *Do you agree or disagree with the principles of the Board structure we outline? Do you consider that these principles can be achieved through the arrangements outlined?*

It is important that all parties commit the appropriate level of seniority and expertise in nominated Board members to ensure that the co-operative governance arrangements are successful. NGN agrees that the central role of the Board should be the consideration of the success of the corporate entity as a whole, including providing overall strategic direction and challenge. This arrangement is consistent with Directors duties laid out in the Companies Act 2006 and should prevent individuals acting primarily in the interest of their employing organisation over the best interest of Xoserve Limited.

The Board is unlikely to become involved in the detailed arrangements associated with normal industry change or the day to day activities of individuals. This level of activity is currently managed by the Executive Committee and contract management arrangements and NGN sees no reason why this would change.

8. *Do you agree or disagree with our initial view that the detail of the establishment and ongoing affairs of the Board are best left for the industry to develop? If you disagree please state what areas you consider that we should require through licence obligations.*

While it would be ideal for industry to agree the exact details of the structure and scope of the new Board, it is likely that there will be some disagreements about the extent to which some organisations or constituencies are represented. NGN has considered this in the context of recent debate about the constituency of the forthcoming Smart Energy Code Panel and Change Board which, after considerable industry debate and lack of overall consensus, was finalised by the Department of

Energy and Climate Change in a structure that did not meet all parties' aspirations. It is worth considering that this may arise during discussions about the future structure and scope of the Board of Xoserve.

Insofar as the ongoing affairs of the Board are consistent with their duties as a Director to promote the success of the company and consider the long term consequences of decisions it is not unreasonable to consider that the industry can develop appropriate arrangements. NGN believes that Ofgem may need to make a final decision should consensus not be possible through industry discussion.

#### *Transition and implementation*

9. *Do you consider that a licence requirement should be placed on one or more parties to ensure that implementation is progressed? If so, what do you consider a reasonable timescale in which full implementation can be complete?*

While a licence condition to ensure implementation may not be necessary, NGN believe that the existing conditions within the Gas Transporter Licence will need to be reviewed to ensure that it remains relevant and accurate given the changes to the arrangements. Consideration of the future pass through arrangements for Gas Transporters for their element of Xoserve costs will also need to be considered to ensure that the mechanism is appropriate, transparent and manageable.

10. *Do you have any views on CEPA's estimated cost of implementation? Please provide evidence of any additional costs you consider should be accounted for.*

NGN has no reason to consider the CEPA estimates are materially inaccurate although we note that these may not include all costs associated with the transition.

#### *General*

11. *Do you have any other comments on any aspect of the CEPA report or this consultation letter?*

NGN believe that the timescales promoted within the CEPA report for completion of this extensive work are extremely challenging. We note that the early stages of this have already slipped by a number of months and that as a result we believe an April 2014 completion to be unachievable. Completion of the administrative requirements together with changes to parties' Licences would be better targeted at April 2015 rather than rush these for a self imposed deadline that has no particular significance.

It is important that in addition to the changes to the charging methodology and invoicing arrangements review of the obligations within the Uniform Network Code will be required to ensure that these are consistent and compatible with the new funding and governance arrangements for the central service provider.